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UNCLAS E F T O SECTION 01 OF 04 OTTAWA 000375

SIPDIS

NOFORN
SENSITIVE

DEPARTMENT FOR EB/IFD, EB/OMA, WHA/EPSC, AND WHA/CAN
STATE PASS FEDERAL RESERVE BANK FOR CHUGH
STATE PASS SEC FOR JACOBS
TREASURY FOR DAVID NAGOSKI AND WILBUR MONROE
PARIS ALSO FOR USOECD

E.O. 12958: N/A

TAGS: [EFIN](#) [ECON](#) [PGOV](#) [CA](#)

SUBJECT: CANADA'S BUDGET: MINORITY STATUS NOT EXPECTED TO
DERAIL THE LIBERALS

REF: A. OTTAWA 336 (OFFSHORE REVENUES)

[B](#). 04 OTTAWA 2560 (HEALTH CARE)

[C](#). 04 OTTAWA 2779 (2004 SURPLUS)

[D](#). 04 OTTAWA 832 (2004 BUDGET)

[1](#). (SBU/noforn) Summary: This year's budget could be a brawl. The budget vote is the only absolute confidence vote that Paul Martin's government will face in the short term and debate is expected to be vigorous. Finance Minister Goodale plans to present the budget to Parliament on February 23. It will be PM Paul Martin's second budget since assuming office and his first as leader of a minority government. We estimate that it will reflect pre-election positioning and contain funding for foreign policy initiatives from the yet-to-be-revealed International Policy Statement (or Review) that has been the subject of contentious inter-agency negotiating for over a year. We are told to expect additional allocations for security, the financial sector and environmental issues, "but nothing major."

[2](#). (SBU/noforn) For the past decade, the Liberal majority could count on the budget being approved by parliament without any changes and with minimal debate. However, this year opposition parties are demanding that their new status be recognized and complain that they are not being adequately consulted. Department of Finance officials find themselves in the new position of reaching out to opposition members and to newly-empowered Liberal party back-benchers. However, the broad consultations seem intended less to find consensus and more to bullet-proof the Liberal's budget from opposition attack. The finance critics of the two largest opposition parties tell us that although they intend to push as hard as they can, they have no interest in bringing down the government over this budget. Parties are staking their turf for the next election and policy makers at Finance appear to welcome the coming confrontation, saying, with gleaming eyes, "If the opposition parties want to present a budget, they should win an election." End summary.

Another boom year - Surplus and Frugality

[3](#). (U) The surplus is on track to be even larger than last year's C\$9 billion (about US\$7 billion). Forecasts of this year's surplus have increased from C\$4 billion in the 2004 budget to almost C\$9 billion by last November, and are still growing. Despite some weakness in the real economy, revenues for the current year (2004-05) are holding up and expenditures are as projected in last year's budget. This provides a fiscal cushion for the government's recent negotiations with the provinces on health care spending, federal provincial transfers ("equalization payments"), and revenue sharing for offshore resources (refs A and B). The accuracy of the government's fiscal forecasts has been a contentious issue (last year's surplus exceeded GOC forecasts by about C\$7 billion (ref C), but even the opposition finance critics now admits efforts to refine the forecasting process are in train.

[4](#). (U) The government-wide expenditure review introduced by PM Martin upon assuming office, whereby each department is to annually identify savings and low-priority spending equivalent to 5% of its budget, has been going smoothly and will provide additional budget flexibility. It will affect each federal department, but many of the savings will be from government-wide initiatives such as more efficient procurement and property management. Finance Minister Ralph Goodale recently told national media that Canadians can expect no pre-election style "goodies," saying he has a plan for the full term and is going to stick to it.

Liberals are reaching out...

[5](#). (SBU/noforn) Just after the June 2004 election, the Department of Finance detailed a senior budget expert to

liaise more directly with Parliamentarians and their staff. The objective was to advance the priorities laid out in the Speech from the Throne as fully as possible. All sides expect the budget process to be much more complex in a minority government, and the government understands that it is important to maintain contact with the opposition and Liberal backbenchers who had not previously been a factor in the budget process. Officials take satisfaction in having "done" health care, equalization, and offshore revenues (refs A and B) so they can focus on the big picture of the Liberal platform: childcare, cities, defense and productivity/prosperity (i.e., taxes). As one contact put it, "the budget is all perception and the parties are claiming their turf."

16. (SBU/NOFORN) A more rambunctious Liberal party caucus provides another new dynamic in the budget process. Recent parliamentary reforms permit any member to introduce a bill. Although they cannot propose increases in revenue or taxes, they can propose spending cuts. So far, 30 bills have been accepted for consideration by the House. Some were ruled out of order (because they involved revenue increases) but four tax-reduction measures are being considered and require time to debate (and hopefully, according to Finance, defeat).

...Sort of

17. (SBU/NOFORN) Finance Minister Goodale and his top officials have traveled the country for pre-budget consultations in every province. There is an effort to allow as many groups as possible to speak to the Minister directly, and regional meetings include the full range of interest groups in each region, with the implicit message that there is stiff competition for funding. The Minister also meets with members of the Liberal Caucus in each province, in recognition of the fact that in a minority government there needs to be extra effort to keep the troops on board. The intensive schedule of consultations does not necessarily reflect a search for consensus. Finance officials seem to relish the expected tussle in Parliament, with more than one Finance contact saying, "We ran on a platform and won."

18. (U) The House Finance Committee should be the only committee to consider the budget, but the dynamics of the budget approval process in a minority government are new to everyone. This is the only absolute confidence vote the Liberal government will face in the short term. Comment: We expect back scratching, log rolling and coalition building, but the extent to which that will result in significant delay or changes to Liberal's budget priorities is unpredictable. End comment.

19. (SBU/NOFORN) One expert close to the budget process noted that, in terms of pre-election positioning, the Conservative party has not really gained strong support from the business community but "the budget could change that, if it's Socialist." However, from what we hear, Martin's team is working hard to make sure their budget cherry-picks the best ideas from each party. Given their healthy fiscal position, there should be no problem funding initiatives that will appeal to voters while still maintaining "balanced budgets or better." Budget officials predict that although the NDP and Bloc Quebecois parties may be "on a different wavelength," the Liberals will be able to work with the Conservatives, but will have to be willing to trade. It would be possible to "do something with the NDP on social issues," but could be expensive.

Conservatives: Cut taxes; support the military

10. (SBU/NOFORN) During a meeting with emboffs last fall, Conservative Party finance critic Monte Solberg said they expect more outreach than in the past by the Liberal party, but had not seen signs of it yet. (Note: the Finance Minister has since held meetings with opposition leaders. End note.) He confirmed that each party is testing the waters in the new minority environment, trying to see how far they can push things without bringing down the government. Conservative Party parliamentarians are considered unlikely to support a no-confidence vote at least until after their policy convention on March 17-19. At this point, the Conservatives do not have a party platform and are thus not in a strong position to contest an election. A financial consultant with experience at the Bank of Canada and Department of Finance who is working on the Conservative party financial platform for the March policy convention said they are working hard to weed divisive items (such as bank mergers) out of the platform.

11. (U) In an open letter to Finance Minister Goodale on January 28, Solberg called on the Liberals to include significant tax cuts (especially on personal income taxes and "job-killing" capital taxes, employment insurance premiums, capital gains taxes); measures to enhance business incentives

and attract investment (improve infrastructure and support cities, refine regulations, raise the capital gains exemption, expand the tuition grant program, remove federal taxes on scholarships); and spending on the military (especially heavy lift capacity) in the upcoming budget. He, like the NDP, called for an independent process for forecasting the financial situation, noting that consistent low-balling of the surplus curtailed discussion of tax cuts. He also wants the budget to "reduce the fiscal imbalance" between the federal and provincial governments (an imbalance federal officials claim does not exist). Solberg was quoted February 4 saying that, short of tax increases or deficit spending (both against the current government's policies), there is no way the Conservatives want to risk forcing an election because Canadian voters simply do not want an election now.

112. (SBU/NOFORN) Comment: Although to us these priorities show a similarity to the government's goals, probably reflecting both Liberal party efforts to undermine the Conservative platform and Conservative efforts to move towards the middle, a GOC official described them as not in alignment with the Liberal's priorities expressed in the Speech from the Throne. End comment.

NDP: Not looking to bring down the government

113. (SBU/NOFORN) The NDP's Finance Critic complained to the press after her recent meeting with the Minister of Finance that the Liberals are shutting out the opposition, but this was clearly political bravado as we were subsequently told by her staff that she felt the "meeting was good." Top officials at Finance note wryly that the publicity "won't encourage further outreach by the Minister." Despite provocative statements by NDP leader Jack Layton on February 4, NDP staffers tell us there is no intention of using the budget to bring down the government, and the party will not "set an impossible target" of items it requires in order to vote for the budget.

114. (U) The NDP shares other opposition parties' outrage at what they perceive as lack of forecasting transparency, and calls for creation of an independent budget office. (Note: For several years the GOC has used surveys of private sector forecasters to estimate the surplus. The evolution of those forecasts is published in the budget document each year. End note.) They want more Parliamentary input on use of the surplus, favoring more gradual debt reduction and higher spending on infrastructure, meeting Kyoto commitments, housing, childcare, and education. They oppose tax cuts, except for low-income citizens.

International Policy Statement: Can't agree, but can budget

115. (SBU/NOFORN) Everyone we talk to who is involved in the long-awaited interagency review of Canada's role in the world, the International Policy Statement, confirms that it has been a much more contentious and difficult process than expected, and there is unlikely to be consensus before the budget. However, the government plans to include in the budget allocations that will support key international priorities. We've been told to look for budget allocations for security, the financial sector and environmental issues, although "nothing major."

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